

Internal Revenue Service

Department of the Treasury

District
Director

1100 Commerce St., Dallas, Texas 75242

Date:

Employer ID Number:

Person to Contact:

Telephone Number:

Refer Reply To:

Dear Sir or Madam:

We have considered your application for recognition of exemption from Federal income tax under section 501(c)(4) of the Internal Revenue Code.

The information submitted indicates that you incorporated in the State of [REDACTED]. Article IV of your Articles of Incorporation states that your purposes include providing for the maintenance and preservation of the properties subject to the Declaration of Covenants, Conditions and Restrictions applicable to [REDACTED], and to promote the health, safety, and welfare of the residents within the above-described property. Article V of your Articles of Incorporation states that each person or entity, who is a record owner of a fee or undivided fee interest in any property which is subject by the Declaration to assessment by you, including contract sellers, shall be a member of your association.

Your Articles of Incorporation were amended on [REDACTED]. They have remained the same for most parts, except that Article V states that you shall have two classes of members. One class is composed of every person or entity who is a record owner of fee simple title to the surface estate of any lot. The other class of members is composed of every person or entity who is the record owner of fee simple title to the surface estate of any commercial unit.

Your 1024 Application for Recognition of Exemption states that you perform the following activities:

- Maintain and landscape explanades, entrances, greenbelts and open areas within your area's boundaries;
- Contract with [REDACTED] to provide police services within your area, in conjunction with [REDACTED]. You pay the Master Community Association ([REDACTED]) your prorated share of the expense associated with the law enforcement contracts;
- Maintain and operate a swimming pool which is available to your members and their guests. Swimming lessons and a swim team are available to your members and the general public;

- Provide and maintain a volleyball court that is available to your members;
- Provide hike and bike trails;
- Provide water, sewage and electricity services for your common areas;
- Contract with a management company to monitor and enforce deed restriction and perform architectural review.

You have two Councils. [REDACTED] has jurisdiction over the commercial units, and [REDACTED] has jurisdiction over the residential units.

You are comprised of [REDACTED] residential parcels with [REDACTED] occupied residences and [REDACTED] commercial lots.

Your financial income is primarily the dues and assessments of your members. You also receive investment and other revenue. Your expenses include the following: Thru [REDACTED] [REDACTED] [REDACTED] [REDACTED]

Swimming Pool Maintenance	\$ [REDACTED]	\$ [REDACTED]		
[REDACTED]	[REDACTED]	[REDACTED]	\$ [REDACTED]	\$ [REDACTED]
Total Expenses	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

Correspondence dated [REDACTED] and provided by your CPA, states the following:

- The balance of the unoccupied parcels are made up of new homes not yet sold and developed and undeveloped lots owned by builders;
- [REDACTED] of the [REDACTED] commercial lots are occupied;
- There are a total of [REDACTED] commercial lots and [REDACTED] residential members. The additional commercial lots are occupied by: a water treatment plant, a gas company, [REDACTED] County MUD #'s [REDACTED] and [REDACTED], a church, a fire department, and county flood control;
- The assessments are based on a review of budgeted income and expenses. The rate of assessment for [REDACTED] is \$[REDACTED] per [REDACTED] square feet of commercial space and \$[REDACTED] per residential lot;
- You are located in an unincorporated area of [REDACTED]'s County. Within your boundaries are numerous commercial properties;
- The volleyball court is open to the public;
- There are no restrictions on the use of the hike and bike trails;
- [REDACTED] is a master association that includes numerous smaller associations. [REDACTED] expense is your prorata share of the master community's budgeted expenses.

per lot. All members would be required to pay their pro rata share of any special assessments.

- The total acreage of the association [redacted] acres;
- [redacted] (replacing [redacted] is the commercial member with the most square footage. The [redacted] assessment amount for this member was \$ [redacted].

Section 501(c) of the Code describes certain organizations exempt from Federal income tax under section 501(a) and reads, in part, as follows:

- 4. "Civil leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes."

Section 1.501(c)(4)-1 of the regulations provides, in part, as follows:

"(a) In general. A civil league or organization may be exempt as an organization described in section 501(c)(4) if -

- 1. It is not organized or operated for profits; and
- 2. It is operated exclusively for the promotion of social welfare."

"(a)(2) i) An organization is operated exclusively for the promotion of social welfare when it is primarily engaged in promoting, in some way, the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements *** The promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office. Nor is an organization operated primarily for the promotion of social welfare if its primary activity is operating a social club for the benefit, pleasure, or recreation of its members, or is carrying on a business with the general public in a manner similar to organizations which are operated for profit.***"

Revenue Ruling 72-102, 1972-1 C.B. 149, describes an organization formed by a developer to preserve the appearance of a housing development and to maintain streets, sidewalks and common areas for the use of the residents, which was found to be exempt under Internal Revenue Code section 501(c)(4). The rationale behind this decision was that the organization served the common good and general welfare of the entire community because it owned and maintained certain non-residential, non-commercial properties of the type normally owned and maintained by municipal governments. Administering and enforcing covenants for preserving the architecture and appearance of a housing development as incidental to the overriding public benefit.

Revenue Ruling 74-99, 1974-1 C.B. 131, modified Revenue Ruling 72-102. It provides that in order to qualify for exemption under IRC 501(c)(4), a

homeowners' association must serve a community, which means a reasonably recognizable relation to an area ordinarily identified as governmental; must not conduct activities directed to the extension maintenance of private residences; and the common areas or facilities it owns and maintains must be for the use and enjoyment of the general public.

According to Revenue Ruling 80-63, 1980-1 CB 116, no hard and fast rule can be applied as to what constitutes a community, but that each case must be examined to determine whether the activities of the organization have sufficient community benefit to serve a social welfare purpose under IRC 501(c)(4). Although the area represented by an association may not be a community, if the association's activities benefit a community, it may still qualify for exemption. This revenue ruling also establishes that the owning and maintaining of parking facilities for the use of its members is for the private benefit of its members, and not for the promotion of social welfare within the meaning of section 501(c)(4) of the Code.

You are made up of commercial members and residential members. Currently there are [] commercial members and [] residential members. From the map of your area, it appears that the commercial area is larger than the residential area. The residential members have paid assessments of approximately \$[] in [] (8 members X \$[] assessment). One commercial member alone has paid an assessment of \$[] in []. It is unknown how much the other commercial members have paid in assessments in [], but it can assuredly be stated that the commercial members have paid substantially more assessments than the residential members.

You can be distinguished from a homeowners' association because you are not controlled by your homeowner members. Your homeowner members have a total of [] votes currently. The most they could have is [] votes since you have [] residential parcels. The commercial members currently have [] votes. Therefore, you are controlled by your commercial members.

These commercial members are assessed based upon their square footage. It can only follow that the commercial members receive benefits based upon the assessment. The more assessed, the more benefits. Those benefits include the security patrol, the maintenance of the common areas and entrances adjacent to their lots and the lighting and maintaining of the streets leading persons to the businesses. The buildings located on the commercial lots are utilized by individuals and companies for the conduct of their businesses. Therefore, you are not a homeowners' association, and the provisions of Revenue Rulings 72-102, 74-99 and 80-63 are not applicable to you.

It is common for a shopping mall, retail center, commercial building or the like to maintain areas such as the right-of-way and explanades encompassed along its boundaries. Since you are maintaining these areas for your commercial members, you are providing a service to the businesses located on your commercial lots, as distinguished from promoting the common good and general welfare of your area.

Since you are primarily made up of commercial lots used by businesses to conduct business, you are not a community for purposes of section 501(c)(4).

That area which is residential is restricted in that only your members and their

guests may use your swimming pool. You also provide your residential members with security services. These are private benefits to your residential members.

For the period [REDACTED] you have paid approximately [REDACTED] percent of your expenses to the [REDACTED] for law enforcement and security patrol. This service is above that already provided by law enforcement officials. This security and law enforcement is a private benefit to your members. Therefore, you are primarily providing private benefits. When you add the expenses for the restricted swimming pool, the amount of your expenses attributable to private benefits rises above [REDACTED] percent.

Since you are primarily providing private benefits to your commercial and residential members, you are not promoting the common good and general welfare of your area. You also are not considered a homeowners' association, and do not qualify for treatment under section 528. Therefore, you should not file Form 1120-H.

Accordingly, it is held that you are not entitled to exemption from Federal income tax as an organization described in IRC 501(c)(4), and you are required to file Federal income tax returns on Form 1120.

If you do not agree with these conclusions, you may, within 30 days from the date of this letter, file in duplicate a brief of the facts, law, and argument that clearly sets forth your position. If you desire an oral discussion of the issue, please indicate this in your protest. The enclosed Publication 392 gives instructions for filing a protest.

If you do not file a protest with this office within 30 days of the date of this report or letter, this proposed determination will become final.

If you agree with these conclusions or do not wish to file a written protest, please sign and return Form 5318 in the enclosed self-addressed envelope as soon as possible.

If you have any further questions, please contact the person whose name and telephone number are shown at the beginning of this letter.

Sincerely,

[REDACTED]
District Director

Enclosures:
Publication 392
Form 5018